IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. ....

KRESGE DEPARTMENT STORES, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I. Opinions Below.

The opinion of the Board of Tax Appeals is reported in 44 B. T. A. 1210. The opinion of the Circuit Court of Appeals is not yet reported, but is printed at page 108 of the record.

II. Statement of the Case.

Section A of the petition contains a statement of facts, to which the Court is respectfully referred. That statement will only be supplemented here, particularly to show that the Petitioner's New York City buying office was an active and ordinary business enterprise rendering services for which it was entirely proper for the Petitioner to charge.

The employees of the office were Petitioner's employees, paid weekly by it. They were hired by Petitioner's manager, and supervised by him (R. 41 and 46). The major activity of the buying office was the purchasing of goods. The usual practice was for the seller to charge the price to the store whose purchase order was being filled. In numerous instances, however, where purchases were made by the New York office, sellers charged the Petitioner. Invoices were marked in evidence to furnish examples of purchases charged to the Petitioner, with the goods in question being subsequently resold to stores which were its clients or customers (R. 41-43). As found by the Board (R. 23), the New York office also did other things. It sought executive personnel for the stores, it sought special attractions, it surveyed weak departments and made recommendations for improvements (R. 43-45).

The scope and magnitude of the purchasing activities of Petitioner is indicated by the testimony (R. 54) that the use by the Newark store of the services of the New York buying office was alone responsible for adding a ten million dollar volume of purchasing power. In many cases, that extra ten million dollars of purchasing power operating through the New York buying office, made it possible to buy more advantageously for the benefit of the Chicago and the Washington stores, in which the Petitioner had a stock interest. The same effect of extra purchasing power was felt to a lesser extent in regard to the smaller store in Asbury Park. Consideration was given by the Petitioner to increasing the volume of the New York buying office by having others participate, and an effort was made to get other department stores interested (R. 54). At one time the

Fresno Dry Goods Store, which has no connection with the Petitioner made use of the services of the buying office (R. 48).

III. Argument.

The buying office of the Petitioner was not an artificial creation, but was an ordinary business enterprise. The Buyer's Manual of the National Retail Dry Goods Association (Rev. ed. 1937) says, in Chapter XXV, pages 341 *et seq.*:

> "Because of the importance of maintaining close contact with the New York market, department stores and specialty stores located outside New York City generally arrange for representation through what are known as resident buying offices. Some of the larger stores maintain their own offices in New York, with staffs of merchandise specialists, but the average-size department or specialty store finds it more economical to operate through a buying office which represents a number of non-competing stores."
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> "To maintain an individual New York buying office is relatively more expensive, however, than to obtain resident buying service from an office that serves other non-competing stores. Moreover, since the buying power of even the larger department stores, when considered in terms of individual departments, is more restricted than the buying power of a group of stores, it is obvious that in some lines an individual store operating its own New York office cannot buy to the same advantage as can a group of stores operating through the same office."

The same work confirms that a fee based on sales volume (as in the present case) is common, by stating (p. 342):

> "Then there are the independent resident buyers, who provide New York market service for numerous department and specialty stores located outside New York City. These independent offices usually charge their subscribing stores an annual fee, the amount of which varies with the annual sales volume of the individual store."

The conduct of Petitioner's buying office was ordinary in all respects, except for the absence of direct profit. The case squarely presents the question of whether charges made to cover costs are gross income. The reasons for reviewing that question are mentioned in the petition.

The opinion of the Circuit Court indicates certain material misapprehensions of fact.

This statement appears in the opinion (R. 110),

> "Neither was it [Petitioner] in the business of performing services for compensation."

If this could be construed as an observation that Petitioner did not charge the various stores enough to realize a profit on the services and facilities furnished by the New York City buying office, then it would be correct. But Petitioner was very definitely in the business of performing services for compensation to the extent of being compensated sufficiently to cover the cost of those services. The question in the case is whether that "compensation" was gross income.

This statement about the Petitioner also appears in the opinion (R. 110):

> "Even the stores in which it had no direct financial interest were supplied with merchandise at its gross cost—without profit to taxpayer and without loss to it. All of the purchasing stores were billed directly and immediately for that part of the gross cost of the goods which represented purchase price. That this amount did not constitue part of taxpayer's gross income is unquestioned. It is our opinion that the part of gross cost representing taxpayer's operating expenses is—under the circumstances of this case—in exactly the same category as that representing purchase price. The impracticality of charging expenses to each lot of merchandise does not make income what would otherwise not be."

This indicates an impression that the Petitioner customarily bought goods, paid for them and then billed the stores for the purchase price. The facts were otherwise. The Petitioner merely acted as a purchasing representative for the stores. The work of locating and selecting goods, etc., was done by Petitioner, but the sales were made to the stores and the stores paid the purchase price, not to the Petitioner, but to the vendor. Such payments of purchase price were of course no part of Petitioner's gross income. In some instances, the Petitioner did buy merchandise in its own name and resold it to the stores at amounts equal to the cost.

It is true that "The impracticality of charging expenses to each lot of merchandise does not make income what would otherwise not be." Yet if payments equalling costs,

without profit, are gross income, they are no less gross income because charged monthly, instead of being charged when each specific service is rendered.

No tax evasion scheme is involved in this case. No such contention has ever been made by the Commissioner or any representative of the Treasury Department. The Petitioner is not a corporation which was at one time subject to the statute and later sought to escape by changed practices. When Petitioner was formed in 1923 (Exhibit P-4, R. 102) central buying for a group of stores was an essential element of the plan. The New York City buying office came into existence then, many years before Congress even thought of a personal holding company tax.

Without a basis in fact the circuit court suggested a tax evasion scheme when it said (R. 110) that "a corporation cannot lift itself out of the class of personal holding company simply by causing non-personal holding company income to flow through its treasury—" and it stated an unsound proposition of law which should be reviewed. A correct statement would be this: In the absence of a plain tax evasion device which should be ignored by the Commissioner and the courts, any corporation which would otherwise be a personal holding company under the statute, will not be one if more than 20 per cent of its gross income is derived from sources other than royalties, dividends, interest, annuities, and gains from the sale of stock or securities. Aside from these specified sources, where the money comes from and how it is received are immaterial questions.

Charges like those made by the Petitioner, which are a part of sound commercial practice, should be recognized

as gross income when paid, even though the charges are equal to costs. In this connection the Court is respectfully urged to consider the reasoning of the Board of Tax Appeals in the *Andrew Jergens Company* case, 40 B. T. A. 868, and the *Bechtel Company* case, 42 B. T. A. 927.

There is no question in the present case about the independent legal obligations which arose as the result of the activities of the New York office of the Petitioner. Many purchases made in the name of the Petitioner followed by subsequent resales to others, are examples of this. The Petitioner hired and paid its own employees. Sellers of goods and employees looked to the Petitioner to satisfy its obligations just as the Standard Oil Company looked to the taxpayer in the *Bechtel* case. If a member of the buying staff of the Petitioner had committed a tort in the course of his employment, the Petitioner would have been liable to the injured party. In short, the Petitioner, to a greater degree than the taxpayers in the *Bechtel* and *Jergens* cases, carried on during the years in question a vigorous, extensive, independent activity through its own employees, as the result of which it received approximately $60,000 in one year and approximately $30,000 in the first five months of the following year. The sums should be included in the Petitioner's "gross income", thereby taking the Petitioner out of the operation of Section 351.

Section 351 of the Revenue Act of 1934 was not intended to apply to such companies as the Petitioner. The section was aimed at the "incorporated pocketbook". (H. R. 704—73rd Cong., 2d Sess.)

It is obvious that a corporation organized long before the statute, with operating rather than holding purposes

expressed in its charter, with 1400-1600 stockholders, with its stock listed and actively traded on the New York Stock Exchange and with a large and active office in New York City employing 25-30 people, the functions of this New York office being the handling of a great volume of commercial transactions having nothing to do with the owning and holding of stocks or notes, is not "an incorporated pocketbook" designed merely to accumulate a personal fortune and therefore is not within the field which Congress meant to cover by the statute.

The intent of the statute was not given sufficient weight by the Circuit Court of Appeals. The statute is penal in nature. It is of great importance to many corporations that the scope of its application be defined.

It is respectfully submitted that the Writ of Certiorari should be allowed.

WARD J. HERBERT,
Counsel of Petitioner.